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ABSTRACT

This summary report is one of a series addressing major policy, management, or program issues facing Congress and the administration. The issues identified in this report indicate the need to: reduce the cost and preserve the integrity of higher education student loan and grant programs; enhance the federal role in monitoring lenders, agencies, and schools involved in grant programs; and strengthen departmental management of data on individual student loans. The complexity of the federal student loan and grant program, coupled with default costs, demands greater departmental control. To enable the system to function effectively, the Secretary of Education should (1) encourage better collection practices by lenders and guaranty agencies; (2) increase incentives for lenders, agencies, and schools to protect federal financial interests; (3) enhance program monitoring of lending participants; and (4) improve the quality of data the Department of Education maintains on individual student loans. To enhance the federal role in elementary and secondary education programs, the Department of Education should (1) provide better guidance for program implementation of Chapter 1 and 2 legislation; and (2) work with states to ensure the availability of nationwide data needed to gauge program success. Finally, the Secretary of Education must strengthen departmental management by increased secretarial involvement and an improved financial management system that prevents waste of resources and generates reliable financial reports. (MLH)

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Transition Series

November 1988

Education Issues

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Comptroller General
of the United States

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The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Education

This summary report is one of a series that addresses major policy, management, or program issues facing the key agency heads of the new administration. These issues, the problems associated with each, and suggested actions were identified as a result of GAO work. Some issues are relatively new, while others represent long-standing and unresolved problems. What they have in common is that they will require attention by the Congress and the new administration.

The new president has pledged to improve the nation's educational system, and we believe that the actions we are recommending will strongly influence how well the Department carries out this mandate. Briefly, the issues in this report discuss the need to (1) reduce the cost and preserve the integrity of higher education programs, (2) enhance the federal role in elementary and secondary education programs, and (3) strengthen departmental management.

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Reducing the Cost and Preserving the Integrity of Higher Education Programs

The United States has the most successful higher education system in the world, and the federal government plays a major role in financing the education of young Americans through loan and grant programs that help millions of students each year. But, the mechanisms for providing financial aid to students are increasingly complex and cumbersome.

These mechanisms involve as many as 14,000 lenders, 8,000 schools, and 47 guaranty agencies that provide loan guarantees, pay lender claims, and ensure lenders follow proper procedures. This complexity, coupled with rising default costs, will present the new administration with a significant management challenge: Can high credibility and affordability be maintained in this vital link in the American education system? And if so, how? A priority for the Department should be to assert more effective management control of these important programs.

To enable this system to function effectively, the Secretary of Education should

- encourage better collection practices by lenders and guaranty agencies;

- increase incentives for lenders, agencies, and schools to protect federal financial interests;
- enhance program monitoring of these participants; and
- improve the quality of data the Department maintains on individual student loans.

Improve Collections and Reduce Defaults

The number of outstanding student loans insured by the Department has grown rapidly, increasing by 100 percent from 1982 to 1987. Overall loan activity was almost $12 billion in 1988 alone. But during the same period, defaults increased by 280 percent, with default claims exceeding $1.6 billion in 1988. Default rates are also substantial: Almost 20 percent of all students who received their last loan in 1983 had defaulted by September 1987. The rising cost of defaults continues to be a matter of concern to both the Congress and the administration.

We have reported on a variety of problems that lenders, guaranty agencies, and the Department have experienced in paying default claims promptly and collecting defaulted loans. We have also shown that certain institutions, particularly profit-motivated trade schools, do a poor job of

managing their loan and grant moneys and have excessive default rates.

More specifically, we have reported instances where

- guaranty agencies fail to use available collection tools, such as the Internal Revenue Service tax refund offset, the resources of state offices, and contract collection agencies;
- lenders have not aggressively pursued defaulters, preferring to submit their claims and leave costly collection efforts to others;
- guaranty agencies have failed to follow their own collection standards and have not required lenders to do so; and
- educational institutions admit students who have little chance of success and who are highly likely to default on their loans.

Also, in an ongoing review of school default rates, we observed that the Department's data base had thousands of missing, incomplete, and inaccurate data entries. These data shortcomings hamper any effort by the Department to better manage its collections or reduce defaults. For example, a recent plan to eliminate

from the loan program those schools with excessive default rates has been severely criticized, principally because of these data base errors.

Recent legislative and administrative changes aimed at enhancing collections and requiring more prudent behavior by lenders and guaranty agencies could help reduce default costs. The Department has shown an interest in making progress, but without continued commitment it will not be realized.

The Secretary should make default management a departmental priority and in particular (1) require that guaranty agencies use all major collection tools generally thought effective, (2) reject insurance claims where the guaranty agency or lender has not adequately met its collection obligations, (3) develop stronger sanctions—as recently proposed—for educational institutions that consistently have high default rates, and (4) develop and implement an improved loan portfolio data base.

Better Incentives Needed to Improve Performance

Further exacerbating the problems of affordability and credibility are weak incentives for the various participants (guaranty agencies, lenders, and schools) to meet their billing, collection, and other responsibilities.

The Department essentially relies on thousands of program participants involved in the loan programs to comply voluntarily with program requirements and to account for payments. However, our recent reports show that incentives for voluntary compliance are lacking. As a result,

- the bills that lenders send to the Department for interest subsidy payments are often inaccurate and overstated,
- guaranty agencies are sometimes slow to remit collection payments to the Department,
- lenders and guaranty agencies are not aggressive in collecting defaulted student loans, and
- educational institutions are often slow to refund tuition when students drop out.

Two examples illustrate this problem. Under current law, the Department can

charge a lender interest on subsidy overpayments only for periods after it notifies the lender of the error. Similarly, its power to assess civil penalties is restricted to situations where it (1) demonstrates that the violations resulted from gross or willful negligence, and then (2) only after it notifies the lender and provides an opportunity to correct deficiencies. In essence, poor management is rewarded because, when overpayments are detected, lenders need to repay only the amounts erroneously billed, thereby receiving the use of interest-free funds.

Similarly, except in cases of gross negligence or willful misconduct, lenders are fully reimbursed by guaranty agencies for defaults, and these agencies in turn are generally fully reimbursed by the federal government. Consequently, neither lenders nor guarantors bear any substantial risk for loan losses, even though they control to a great extent the government's losses through their lending and collection practices. If these participants were to bear a greater proportion of the risk of loss when borrowers failed to repay, perhaps they would work more aggressively to collect these loans.

In our past reports we have made a variety of specific proposals to help solve

these problems. Many of our suggestions have involved sanctions or incentives aimed at improving the performance of lenders and guaranty agencies. Some would require legislation, but others could be implemented by the Department.

The Secretary should work to improve incentives for lenders, guaranty agencies, and educational institutions to better protect federal interests and in particular seek legislation (and take other administrative actions) to allow the imposition of interest penalties where needed. The Secretary should also authorize limited risk-sharing with lenders and guaranty agencies in the Department's loan insurance activities.

Improve Program Monitoring

Inadequate monitoring by the Department also contributes to problems in the student loan program. We have reported during the last few years on a variety of problems the guaranty agencies and lenders have experienced in their operations that have gone undetected or uncorrected.

For example, we reported recently that the Department

- failed to detect millions of dollars in interest subsidy overpayments to major lenders and

- paid insurance claims on millions of dollars of defaulted loans, which we believe could have been rejected had deficiencies in lender and guaranty agency lending practices been detected.

We recognize that the monitoring of lenders and guaranty agencies is expensive and time consuming, but without it we believe these institutions will place a low priority on complying with program requirements. Even with limited resources, the Department could do a better job by developing strategies that involve coordination among federal, state, and private sector audit agencies and are more effective at targeting problem agencies and lenders for such reviews. Rather than continuing to deemphasize this important activity, as has been done in recent years, we believe it should be revived and strengthened.

The Secretary of Education should direct the Inspector General and other key Department officials to develop a strategy in which the Department's resources and those of guaranty agencies and private sector audit agencies are employed in an effective and coordinated effort to assure compliance with program objectives.

Enhancing the Federal Role in Elementary and Secondary Education Programs

The president-elect has emphasized the need to improve the American education system, and the Department will likely be judged on how well it provides federal leadership in accomplishing this goal, particularly in elementary and secondary education. In school year 1987-88, approximately $11.2 billion in federal funding was provided to support elementary and secondary education programs at the state and local levels. While this represents only about 6 percent of all funding for such educational programs, it is vitally important. These funds support programs that are the vehicles through which national goals are translated into change at the state and local levels. Our work shows that better policy guidance and better state program data could help the Department ensure that national goals are achieved.

Provide Better Guidance for Program Implementation

We identified numerous situations where better guidance to states from the Department could improve program operations.

For example, the Department has not given states specific guidance on the severity of handicapping conditions for eligibility for the state-operated Chapter 1 program, which provides $150 million annually to educate handicapped students. In the absence of guidance, a small number

of states have qualified for greater funding by counting students with less severe handicapping conditions. Substantial funding for these states has come at the expense of other states that have counted only those with severe handicaps. In other words, the lack of guidance has allowed a minority of states to capture a disproportionate share of program funding.

Similarly, the Department has not done a good job of communicating policy guidance on matching requirements for grants under the $888 million federal vocational education program. As a result, federal funds targeted to needy students in certain locations are not being used because some state and local officials do not know that federal funds can be matched on a statewide basis. Some school districts have turned back funds because they could not provide the match, while other districts in the state had more than enough matching funds to make up the shortfall.

The Secretary needs to review state-administered education programs to assure that states and localities have sufficient federal guidance to properly implement the intent of the program legislation.

State Data for Congressional and Management Oversight Limited

The Department has generally failed to supply the leadership to assure the availability of nationwide education data needed to gauge the success of federal programs and determine the need for program changes. In our reviews of Department programs, we have repeatedly found old and incomplete data and inconsistent definitions that make state-to-state comparisons extremely difficult.

For example, in 1984, the Congress required state education agencies to prepare annual evaluations on the effectiveness of the $500 million Chapter 2 education block grant program. However, the Department provided no uniform data collection and reporting formats. As a result, states reported data using such a variety of formats and data categories that it was almost impossible to compare one state to another, let alone understand what was happening nationwide. State education officials have recently taken the initiative to cooperatively develop a reporting format, but many states have not yet followed the format to provide uniform national data to adequately evaluate the $2 billion appropriated since 1984.

Nationwide comparable data are also unavailable for management and oversight of vocational education programs, for

which reauthorization hearings will begin in the spring of 1989. A computerized system for collecting nationwide data on local activities was terminated several years ago because of data accuracy and definitional problems. The Department has yet to develop a replacement system, although there is a broad consensus among state and local school officials that such a system is needed. Partly in response to this situation, the Congress funded a separate major evaluation study to prepare for reauthorization; the study has involved extensive primary data collection. Unless the Department acts to obtain needed information, the Congress is likely to continue mandating data collection as various programs are reauthorized.

At the same time that useful elementary and secondary education data were unavailable, the number of program evaluation studies done by the Department declined by over 70 percent. Moreover, existing evaluation data were often outdated, and the technical quality varied.

The Secretary should survey the information needed on major elementary and secondary education programs and work in cooperation with states and localities to develop standard reporting formats and definitions of data elements.

Strengthening Departmental Management

Effective management systems are critical to the Department's ability to accomplish its mission. We studied selected aspects of departmental management in recent years and plan to undertake a comprehensive review of departmental management within the next 2 years. Recent work, however, shows that benefits could accrue from making certain improvements now. These include

- developing an operational management system that sets a realistic number of major program priorities and tracks success against these priorities and
- improving financial management systems to address accounting and internal control weaknesses.

Increased Secretarial Involvement Could Improve Federal Impact

Traditionally, the Department has operated as a conglomerate of largely independent entities. Essentially, strategic planning and program management were delegated to various assistant secretaries. Broad philosophical guidance regarding Department programs was provided by the Secretary to senior officials, and the Secretary expected these officials to evaluate their own efforts toward achieving his goals and objectives. Senior officials were to ensure that their plans and activities

reflected the concerns laid out in the Secretary's guidance.

Our recent management work shows that an effective management system has not been established for the Department. For example, senior officials have not generally established the subsidiary goals envisioned by the Secretary. We believe a management system is needed, and our work at other departments has shown that there are a variety of ways to structure and operate such a system. There are, however, certain critical elements, foremost of which is the need for strong secretarial involvement. Other critical elements include

- setting a reasonable number of major goals or priorities,
- monitoring progress against these goals, and
- providing periodic feedback on success to senior agency managers.

To enhance departmental leadership in American education, the Secretary should establish a secretarial management system.

Improve Financial Management

Key accounting and related internal control systems operated by the Department and certain schools have serious accounting and internal control weaknesses. As a result, (1) billions of dollars in federal funds and other financial resources are not adequately protected from fraud, waste, and mismanagement and (2) the Department's financial reports are unreliable, in part, because they are not derived from its accounting systems.

Our December 1987 report discussed (1) poor loan records, (2) inadequate accounting for and control over property, (3) accounting system weaknesses resulting in erroneous grant disbursements, and (4) an inadequate general ledger system. As a result, about $16 billion of federal funds and other financial resources are not adequately protected. Similar to the situation discussed earlier pertaining to program data, the financial data are also unreliable.

In the spring of 1988, the Department initiated efforts to modernize its financial management system. It also put in place a mechanism to track the development of this system and the upgraded projects.

The Secretary should ensure that these initial efforts continue, and develop the appropriate systems to address its

accounting and internal control weaknesses.

Related GAO Products

Guaranteed Student Loans: Lenders' Interest Billings Often Result in Overpayments (GAO/HRD-88-72, Aug. 31, 1988).

Vocational Education: Information on the National Research Center's Grant Award Process (GAO/HRD-88-56, Jan. 29, 1988).

Guaranteed Student Loans: Potential Default and Cost Reduction Options (GAO/HRD-88-52BR, Jan. 7, 1988).

Financial Management: Overall Plan Needed to Guide System Improvements at Education (GAO/AFMD-88-15, Dec. 31, 1987).

Guaranteed Student Loans: Legislative and Regulatory Changes Needed to Reduce Default Costs (GAO/HRD-87-76, Sept. 30, 1987).

Defaulted Student Loans: Private Lender Collection Efforts Often Inadequate (GAO/HRD-87-48, Aug. 20, 1987).

Compensatory Education: Chapter 1 Participants Generally Meet Selection Criteria (GAO/HRD-87-26, Jan. 30, 1987).

Block Grants: Education Block Grant Alters State Role and Provides Greater Local Discretion (GAO/HRD-85-18, Nov. 19, 1984).

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